



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-72607; File No. SR-NASDAQ-2014-057]

### **Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of Proposed Rule Change Relating to the Listing and Trading of the Shares of the First Trust Low Duration Mortgage Opportunities ETF of First Trust Exchange-Traded Fund IV**

July 15, 2014

#### **I. Introduction**

On May 20, 2014, The NASDAQ Stock Market LLC (“Nasdaq” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares (“Shares”) of the First Trust Low Duration Mortgage Opportunities ETF (“Fund”) of First Trust Exchange-Traded Fund IV (“Trust”) under Nasdaq Rule 5735, which governs the listing and trading of Managed Fund Shares on the Exchange. The proposed rule change was published for comment in the Federal Register on June 5, 2014.<sup>3</sup> The Commission received no comments on the proposed rule change. This order grants approval of the proposed rule change.

#### **II. Description of Proposed Rule Change**

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 72281 (May 30, 2014), 79 FR 32586 (“Notice”).

The Exchange has made the following representations and statements in describing the Fund and its investment strategies, including other portfolio holdings and investment restrictions.<sup>4</sup>

### General

The Fund will be an actively-managed exchange-traded fund (“ETF”). The Shares will be offered by the Trust, which was established as a Massachusetts business trust on September 15, 2010. The Trust is registered with the Commission as an investment company and has filed a registration statement on Form N-1A (“Registration Statement”) with the Commission.<sup>5</sup> The Fund will be a series of the Trust. First Trust Advisors L.P. will be the investment adviser (“Adviser”) to the Fund.<sup>6</sup> First Trust Portfolios L.P. (“Distributor”) will be

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<sup>4</sup> The Commission notes that additional information regarding the Trust, the Fund, and the Shares, including investment strategies, risks, net asset value (“NAV”) calculation, creation and redemption procedures, fees, Fund holdings disclosure policies, distributions, and taxes, among other information, is included in the Notice and the Registration Statement, as applicable. See Notice and Registration Statement, supra note 3 and infra note 5, respectively.

<sup>5</sup> See Post-Effective Amendment No. 69 to Registration Statement on Form N-1A for the Trust, dated May 16, 2014 (File Nos. 333-174332 and 811-22559). The Exchange states that the Commission has issued an order granting certain exemptive relief under the Investment Company Act of 1940 (“1940 Act”). See Investment Company Act Release No. 30029 (April 10, 2012) (File No. 812-13795) (“Exemptive Relief”). In addition, the Exchange states that on December 6, 2012, the staff of the Commission’s Division of Investment Management (“Division”) issued a no-action letter (“No-Action Letter”) relating to the use of derivatives by actively-managed ETFs. See No-Action Letter dated December 6, 2012 from Elizabeth G. Osterman, Associate Director, Office of Exemptive Applications, Division. The Exchange states that the No-Action Letter stated that the Division would not recommend enforcement action to the Commission under applicable provisions of and rules under the 1940 Act if actively-managed ETFs operating in reliance on specified orders (which include the Exemptive Relief) invest in options contracts, futures contracts, or swap agreements, provided that they comply with certain representations stated in the No-Action Letter.

<sup>6</sup> The Exchange states that the Adviser is not a broker-dealer, but it is affiliated with the Distributor, a broker-dealer. The Exchange states that the Adviser has implemented a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition of or changes to the portfolio, and that personnel who make decisions on

the principal underwriter and distributor of the Fund's Shares. The Bank of New York Mellon Corporation will act as the administrator, accounting agent, custodian, and transfer agent to the Fund.<sup>7</sup>

### Principal Investments

The primary investment objective of the Fund will be to generate current income, and its secondary objective will be capital appreciation. Under normal market conditions,<sup>8</sup> the Fund will seek to achieve its investment objectives by investing at least 80% of its net assets (including investment borrowings) in the mortgage-related debt securities and other mortgage-related instruments (collectively, "Mortgage-Related Investments") described below.

Under normal market conditions, the Fund will invest in Mortgage-Related Investments tied to residential and commercial mortgages.<sup>9</sup> Mortgage-Related Investments represent an

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the Fund's portfolio composition will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding the Fund's portfolio. The Exchange further states that, in the event (a) the Adviser or any sub-adviser becomes, or becomes newly affiliated with, a broker-dealer, or (b) any new adviser or sub-adviser is a registered broker-dealer or becomes affiliated with a broker-dealer, the adviser or sub-adviser, as applicable, will implement a fire wall with respect to its relevant personnel or its broker-dealer affiliate, as applicable, regarding access to information concerning the composition of or changes to the portfolio and will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding the portfolio.

<sup>7</sup> The Exchange states that the Fund currently does not intend to use a sub-adviser.

<sup>8</sup> The term "under normal market conditions" as used herein includes, but is not limited to, the absence of adverse market, economic, political, or other conditions, including extreme volatility or trading halts in the fixed income markets or the financial markets generally; operational issues causing dissemination of inaccurate market information; or force majeure type events such as systems failure, natural or man-made disaster, act of God, armed conflict, act of terrorism, riot, labor disruption, or any similar intervening circumstance.

<sup>9</sup> Mortgage-Related Investments consist of: (1) residential mortgage-backed securities ("RMBS"); (2) commercial mortgage-backed securities ("CMBS"); (3) stripped mortgage-backed securities ("SMBS"), which are mortgage-backed securities where mortgage payments are divided between paying the loan's principal and paying the loan's

interest in a pool of mortgage loans made by banks and other financial institutions to finance purchases of homes, commercial buildings, and other real estate. The individual mortgage loans are packaged or “pooled” together for sale to investors. As the underlying mortgage loans are paid off, investors receive principal and interest payments. Mortgage-Related Investments may be fixed-rate instruments, or they may be adjustable-rate instruments (“ARMS”).

The Mortgage-Related Investments in which the Fund will invest may be, but are not required to be, issued or guaranteed by the U.S. government or by its agencies or instrumentalities, such as Ginnie Mae and U.S. government-sponsored entities, such as Fannie Mae and Freddie Mac (the U.S. government, its agencies and instrumentalities, and U.S. government-sponsored entities are referred to collectively as “Government Entities”).<sup>10</sup> The Fund may invest in callable agency securities, which give the issuer (the U.S. government agency) the right to redeem the security prior to maturity. The Fund will limit its investments in

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interest; and (4) collateralized mortgage obligations (“CMOs”) and real estate mortgage investment conduits (“REMICs”), which are mortgage-backed securities that are divided into multiple classes, with each class being entitled to a different share of the principal and interest payments received from the pool of underlying assets.

<sup>10</sup> Securities issued by Government Entities have different levels of credit support. For example, Ginnie Mae securities carry a guarantee as to the timely repayment of principal and interest that is backed by the full faith and credit of the U.S. government. However, the full faith and credit guarantee does not apply to the market prices and yields of the Ginnie Mae securities or to the NAV, trading price, or performance of the Fund, which will vary with changes in interest rates and other market conditions. Fannie Mae and Freddie Mac pass-through mortgage certificates are backed by the credit of the respective instrumentality and are not guaranteed by the U.S. government. Other securities issued by Government Entities may only be backed by the creditworthiness of the issuing institution, not the U.S. government, or the issuers may have the right to borrow from the U.S. Treasury to meet their obligations.

Mortgage-Related Investments that are not issued or guaranteed by Government Entities to 20% of its net assets.<sup>11</sup>

Many Mortgage-Related Investments are pass-through securities, which means they provide investors with monthly payments consisting of a pro rata share of both regular interest and principal payments as well as unscheduled prepayments on the underlying mortgage loans. Because prepayment rates of individual mortgage pools vary widely, the average life of a particular pool cannot be predicted accurately.

The Fund currently targets an estimated effective duration<sup>12</sup> of three years or less. The Adviser will calculate the duration of the portfolio by modeling the cash flows of all the individual holdings, including the impact of prepayment variability and coupon adjustments, where applicable, to determine the duration of each holding and then aggregating based on the size of the position. In performing this duration calculation, the Adviser will utilize third-party models.

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<sup>11</sup> For the avoidance of doubt, Mortgage-Related Investments that are not issued or guaranteed by Government Entities will be included for purposes of the 80% requirement described in the first paragraph under the heading “Principal Investments.”

<sup>12</sup> In comparison to maturity (which is the date on which a debt instrument ceases and the issuer is obligated to repay the principal amount), duration is a measure of the expected price volatility of a debt instrument as a result of changes in market rates of interest, based on the weighted average timing of the instrument’s expected principal and interest payments and other factors. Duration differs from maturity in that it considers a security’s yield, coupon payments, principal payments, call features, and coupon adjustments in addition to the amount of time until the security finally matures. As the value of a security changes over time, so will its duration. Prices of securities with lower durations tend to be less sensitive to interest rate changes than securities with higher durations. In general, a portfolio of securities with a lower duration can be expected to be less sensitive to interest rate changes than a portfolio with a higher duration.

The Fund may invest, without limitation, in mortgage dollar rolls.<sup>13</sup> The Fund intends to enter into mortgage dollar rolls only with high quality securities dealers and banks, as determined by the Adviser. The Fund may also invest in to-be-announced transactions (“TBA Transactions”).<sup>14</sup> Further, the Fund may enter into short sales as part of its overall portfolio management strategies or to offset a potential decline in the value of a security; however, the Fund does not expect, under normal market conditions, to engage in short sales with respect to more than 30% of the value of its net assets. To the extent required under applicable federal securities laws, rules, and interpretations thereof, the Fund will set aside liquid assets or engage in other measures to cover open positions and short positions held in connection with the foregoing types of transactions.

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<sup>13</sup> In a mortgage dollar roll, the Fund will sell (or buy) mortgage-backed securities for delivery on a specified date and simultaneously contract to repurchase (or sell) substantially similar (same type, coupon, and maturity) securities on a future date. During the period between a sale and repurchase, the Fund will forgo principal and interest paid on the mortgage-backed securities. The Fund will earn or lose money on a mortgage dollar roll from any difference between the sale price and the future purchase price. In a sale and repurchase, the Fund will also earn money on the interest earned on the cash proceeds of the initial sale.

<sup>14</sup> A TBA Transaction is a method of trading mortgage-backed securities. TBA Transactions generally are conducted in accordance with widely-accepted guidelines that establish commonly observed terms and conditions for execution, settlement, and delivery. In a TBA Transaction, the buyer and the seller agree on general trade parameters such as agency, settlement date, par amount, and price. The actual pools delivered generally are determined two days prior to the settlement date. The mortgage TBA market is liquid, and positions can be easily added, rolled, or closed. According to the Financial Industry Regulatory Authority (“FINRA”) Trade Reporting and Compliance Engine (“TRACE”) data, TBA Transactions represented approximately 93% of total trading volume for agency mortgage-backed securities in the month of January 2014.

Although the Fund intends to invest primarily in investment grade securities,<sup>15</sup> the Fund may invest up to 20% of its net assets in securities of any credit quality, including securities that are below investment grade and securities that are unrated and have not been judged by the Adviser to be of comparable quality to rated investment grade securities.

### Other Investments

The Fund may invest in exchange-listed options on U.S. Treasury securities, exchange-listed options on U.S. Treasury futures contracts, and exchange-listed U.S. Treasury futures contracts.<sup>16</sup> The use of these derivative transactions may allow the Fund to obtain net long or short exposures to selected interest rates or durations. These derivatives may also be used to hedge risks associated with the Fund's other portfolio investments.

Under normal market conditions, no more than 20% of the value of the Fund's net assets

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<sup>15</sup> Investment grade securities include securities with, at the time of investment, credit ratings within the four highest rating categories of a nationally recognized statistical rating organization such as Moody's Investors Service, Inc. ("Moody's"), Fitch Ratings ("Fitch"), Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P Ratings"), or another nationally recognized statistical rating organization ("NRSRO"), and unrated securities judged to be of comparable quality by the Adviser. Comparable quality of unrated securities will be determined by the Adviser based on fundamental credit analysis of the unrated security and comparable NRSRO-rated securities. On a best-efforts basis, the Adviser will attempt to make a rating determination based on publicly available data. In making a "comparable quality" determination, the Adviser may consider, for example, whether the issuer of the security has issued other rated securities, the nature and provisions of the relevant security, whether the obligations under the relevant security are guaranteed by another entity and the rating of such guarantor (if any), relevant cash flows, macroeconomic analysis, and sector or industry analysis.

<sup>16</sup> At least 90% of the Fund's net assets that are invested in exchange-traded equity securities and exchange-traded derivatives (in the aggregate) will be invested in investments that trade in markets that are members of the Intermarket Surveillance Group ("ISG") or are parties to a comprehensive surveillance sharing agreement with the Exchange.

will be invested in derivative instruments.<sup>17</sup> The Fund's investments in derivative instruments will be consistent with the Fund's investment objectives and the 1940 Act and will not be used to seek to achieve a multiple or inverse multiple of an index.

The Fund may invest up to 20% of its net assets in short-term debt securities, money market funds, and other cash equivalents, or it may hold cash. The percentage of the Fund invested in such holdings will vary and will depend on several factors, including market conditions. For temporary defensive purposes, during the initial invest-up period and during periods of high cash inflows or outflows, the Fund may depart from its principal investment strategies and invest part or all of its assets in these securities or it may hold cash. During such periods, the Fund may not be able to achieve its investment objectives. The Fund may adopt a defensive strategy when the Adviser believes that securities in which the Fund normally invests have elevated risks due to political or economic factors and in other extraordinary circumstances.

Short-term debt securities are securities from issuers having a long-term debt rating of at least A by S&P Ratings, Moody's, or Fitch and having a maturity of one year or less. The use of temporary investments will not be a part of a principal investment strategy of the Fund.

Short-term debt securities are defined to include, without limitation, the following:

(1) fixed rate and floating rate U.S. government securities, including bills, notes, and bonds

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<sup>17</sup> The Fund will limit its direct investments in futures and options on futures to the extent necessary for the Adviser to claim the exclusion from regulation as a "commodity pool operator" with respect to the Fund under Rule 4.5 promulgated by the Commodity Futures Trading Commission ("CFTC"), as such rule may be amended from time to time. Under Rule 4.5 as currently in effect, the Fund will limit its trading activity in futures and options on futures (excluding activity for "bona fide hedging purposes," as defined by the CFTC) such that it will meet one of the following tests: (i) aggregate initial margin and premiums required to establish its futures and options on futures positions will not exceed 5% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions; or (ii) aggregate net notional value of its futures and options on futures positions will not exceed 100% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions.



differing as to maturity and rates of interest, which are either issued or guaranteed by the U.S. Treasury or by U.S. government agencies or instrumentalities; (2) certificates of deposit issued against funds deposited in a bank or a savings and loan association; (3) bankers' acceptances, which are short-term credit instruments used to finance commercial transactions; (4) repurchase agreements,<sup>18</sup> which involve purchases of debt securities; (5) bank time deposits, which are monies kept on deposit with banks or savings and loan associations for a stated period of time at a fixed rate of interest; and (6) commercial paper, which is short-term unsecured promissory notes. The Fund may only invest in commercial paper rated A-1 or higher by S&P Ratings, Prime-1 or higher by Moody's, or F1 or higher by Fitch.

In addition to its investments in Mortgage-Related Investments issued or guaranteed by Government Entities (as described in Principal Investments above) and in the short-term debt securities described in clause (1) of the preceding paragraph, the Fund may also invest up to 20% of its net assets in other direct obligations of the U.S. government and in other securities issued or guaranteed by Government Entities. Such investments may include, without limitation, U.S. government inflation-indexed securities.<sup>19</sup>

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<sup>18</sup> The Fund intends to enter into repurchase agreements only with financial institutions and dealers believed by the Adviser to present minimal credit risks in accordance with criteria approved by the Board of Trustees of the Trust ("Trust Board"). The Adviser will review and monitor the creditworthiness of such institutions. The Adviser will monitor the value of the collateral at the time the transaction is entered into and at all times during the term of the repurchase agreement.

<sup>19</sup> Inflation-indexed securities are fixed-income securities that are structured to provide protection against inflation. The value of the security's principal or the interest income paid on the security is adjusted to track changes in an official inflation measure. The U.S. Treasury uses the Consumer Price Index for Urban Consumers as the inflation measure.

The Fund may invest up to 20% of its net assets in the securities of other investment companies, including money market funds (as noted above) and other ETFs.<sup>20</sup>

The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment), including securities deemed illiquid by the Adviser.<sup>21</sup> The Fund will monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or other circumstances, more than 15% of the Fund's net assets are held in illiquid assets. Illiquid assets include securities subject to contractual or other restrictions on resale and other instruments that lack readily available markets as determined in accordance with Commission staff guidance.

The Fund may not invest 25% or more of the value of its total assets in securities of issuers in any one industry. This restriction does not apply to obligations issued or guaranteed

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<sup>20</sup> An ETF is an investment company registered under the 1940 Act that holds a portfolio of securities. Many ETFs are designed to track the performance of a securities index, including industry, sector, country, and region indexes. ETFs included in the Fund will be listed and traded in the U.S. on registered exchanges. The Fund may invest in the securities of ETFs in excess of the limits imposed under the 1940 Act pursuant to exemptive orders obtained by other ETFs and their sponsors from the Commission. In addition, the Fund may invest in the securities of certain other investment companies in excess of the limits imposed under the 1940 Act pursuant to an exemptive order that the Trust has obtained from the Commission. The ETFs in which the Fund may invest include Index Fund Shares (as described in Nasdaq Rule 5705), Portfolio Depository Receipts (as described in Nasdaq Rule 5705), and Managed Fund Shares (as described in Nasdaq Rule 5735). While the Fund may invest in inverse ETFs, the Fund will not invest in leveraged or inverse leveraged (e.g., 2X or -3X) ETFs.

<sup>21</sup> In reaching liquidity decisions, the Adviser may consider the following factors: the frequency of trades and quotes for the security; the number of dealers wishing to purchase or sell the security and the number of other potential purchasers; dealer undertakings to make a market in the security; and the nature of the security and the nature of the marketplace in which it trades (e.g., the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer).

by the U.S. government, or by its agencies or instrumentalities, or to securities of other investment companies.

The Fund intends to qualify each year as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, as amended.

### III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act<sup>22</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>23</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>24</sup> which requires, among other things, that the Exchange's rules be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission notes that the Fund and the Shares must comply with the initial and continued listing criteria in Nasdaq Rule 5735 for the Shares to be listed and traded on the Exchange.

The Commission finds that the proposal to list and trade the Shares on the Exchange is consistent with Section 11A(a)(1)(C)(iii) of the Act,<sup>25</sup> which sets forth Congress' finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for, and transactions in, securities. Quotation and last sale information for the Shares will be available via Nasdaq proprietary quote and trade services, as well as in

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<sup>22</sup> 15 U.S.C. 78f.

<sup>23</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>24</sup> 15 U.S.C. 78f(b)(5).

<sup>25</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii).

accordance with the Unlisted Trading Privileges and the Consolidated Tape Association (“CTA”) plans for the Shares. In addition, the Intraday Indicative Value,<sup>26</sup> as defined in Nasdaq Rule 5735(c)(3), available on the NASDAQ OMX Information LLC proprietary index data service, will be widely disseminated by one or more major market data vendors and broadly displayed at least every 15 seconds during the Regular Market Session.<sup>27</sup> On each business day, before commencement of trading in Shares in the Regular Market Session<sup>28</sup> on the Exchange, the Fund will disclose on its website the identities and quantities of the portfolio of securities and other assets (the “Disclosed Portfolio” as defined in Nasdaq Rule 5735(c)(2)) held by the Fund that will form the basis for the Fund’s calculation of NAV at the end of the business day.<sup>29</sup> The

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<sup>26</sup> According to the Exchange, the Intraday Indicative Value reflects an estimated intraday value of the Fund’s Disclosed Portfolio. The Intraday Indicative Value will be based upon the current value for the components of the Disclosed Portfolio. The Intraday Indicative Value will be based on quotes and closing prices from the securities’ local market and may not reflect events that occur subsequent to the local market’s close. Premiums and discounts between the Intraday Indicative Value and the market price may occur. The Intraday Indicative Value should not be viewed as a “real time” update of the NAV per Share of the Fund, which is calculated only once a day.

<sup>27</sup> Currently, the NASDAQ OMX Global Index Data Service (“GIDS”) is the NASDAQ OMX global index data feed service. The Exchange represents that GIDS offers real-time updates, daily summary messages, and access to widely followed indexes and Intraday Indicative Values for ETFs and that GIDS provides investment professionals with the daily information needed to track or trade NASDAQ OMX indexes, listed ETFs, or third-party partner indexes and ETFs.

<sup>28</sup> See Nasdaq Rule 4120(b)(4) (describing the three trading sessions on the Exchange: (1) Pre-Market Session from 4 a.m. to 9:30 a.m., Eastern Time; (2) Regular Market Session from 9:30 a.m. to 4:00 p.m. or 4:15 p.m., Eastern Time; and (3) Post-Market Session from 4:00 p.m. or 4:15 p.m. to 8:00 p.m., Eastern Time).

<sup>29</sup> The Fund’s disclosure of derivative positions in the Disclosed Portfolio will include information that market participants can use to value these positions intraday. On a daily basis, the Fund will disclose on the Fund’s website the following information regarding each portfolio holding, as applicable to the type of holding: ticker symbol, CUSIP number or other identifier, if any; a description of the holding (including the type of holding); the identity of the security or other asset or instrument underlying the holding, if any; for options, the option strike price; quantity held (as measured by, for example, par value, notional value or number of shares, contracts or units); maturity date, if any;

Fund's custodian, through the National Securities Clearing Corporation ("NSCC"), will make available on each business day, prior to the opening of business of the Exchange, the list of the names and quantities of the instruments, as well as amount of cash (if any), constituting the creation basket for that day. The NAV of the Fund will be determined as of the close of trading (normally 4:00 p.m., Eastern Time) on each day the New York Stock Exchange is open for business.<sup>30</sup> Information regarding market price and trading volume of the Shares will be continually available on a real-time basis throughout the day on brokers' computer screens and other electronic services. Information regarding the previous day's closing price and trading volume information for the Shares will be published daily in the financial section of newspapers. Intraday executable price information for fixed income securities, exchange-traded equity securities, and derivatives held by the Fund will be available from major broker-dealer firms and major market data vendors. Additionally, FINRA's TRACE will be a source of price information for certain of the Mortgage-Related Investments held by the Fund. For exchange-traded assets, intraday price information will be available directly from the applicable listing exchanges. Intraday price information will also generally be available through subscription services, which can be accessed by authorized participants and other investors. Registered open-end management investment companies (other than ETFs) are generally priced once each business day, and these prices are available through the applicable fund's website or major market data vendors. The Fund's website will include a form of the prospectus for the Fund and additional data relating to NAV and other applicable quantitative information.

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coupon rate, if any; effective date, if any; market value of the holding; and the percentage weighting of the holding in the Fund's portfolio.

<sup>30</sup> NAV will be calculated for the Fund by taking the market price of the Fund's total assets, including interest or dividends accrued but not yet collected, less all liabilities, and dividing this amount by the total number of Shares outstanding.

The Commission further believes that the proposal to list and trade the Shares is reasonably designed to promote fair disclosure of information that may be necessary to price the Shares appropriately and to prevent trading when a reasonable degree of transparency cannot be assured. The Exchange will obtain a representation from the issuer of the Shares that the NAV per Share will be calculated daily and that the NAV and the Disclosed Portfolio will be made available to all market participants at the same time. Trading in Shares of the Fund will be halted under the conditions specified in Nasdaq Rules 4120 and 4121, including the trading pause provisions under Nasdaq Rules 4120(a)(11) and (12). Trading in the Shares may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable,<sup>31</sup> and trading in the Shares will be subject to Nasdaq Rule 5735(d)(2)(D), which sets forth circumstances under which trading in Shares of the Fund may be halted. The Exchange states that it has a general policy prohibiting the distribution of material, non-public information by its employees. Further, the Commission notes that the Reporting Authority that provides the Disclosed Portfolio must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material, non-public information regarding the actual components of the portfolio.<sup>32</sup> In addition, the Exchange states that the Adviser is not a broker-dealer, but it is affiliated with a broker-dealer and has implemented a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition of changes to the portfolio, and personnel who make decisions on the Fund's portfolio

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<sup>31</sup> These reasons may include: (1) the extent to which trading is not occurring in the securities and/or the other assets constituting the Disclosed Portfolio of the Fund; or (2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. With respect to trading halts, the Exchange may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares of the Fund.

<sup>32</sup> See Nasdaq Rule 5735(d)(2)(B)(ii).

composition will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding the Fund's portfolio.<sup>33</sup> The Exchange represents that trading in the Shares will be subject to the existing trading surveillances, administered by both Nasdaq and also FINRA on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.<sup>34</sup> The Exchange further represents that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws. Moreover, prior to the commencement of trading, the Exchange states that it will inform its members in an Information Circular of the special characteristics and risks associated with trading the Shares.

The Exchange represents that the Shares are deemed to be equity securities, thus rendering trading in the Shares subject to the Exchange's existing rules governing the trading of

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<sup>33</sup> See supra note 6. The Exchange states that an investment adviser to an open-end fund is required to be registered under the Investment Advisers Act of 1940 ("Advisers Act"). As a result, the Adviser and its related personnel are subject to the provisions of Rule 204A-1 under the Advisers Act relating to codes of ethics. This Rule requires investment advisers to adopt a code of ethics that reflects the fiduciary nature of the relationship to clients, as well as compliance with other applicable securities laws. Accordingly, procedures designed to prevent the communication and misuse of non-public information by an investment adviser must be consistent with Rule 204A-1 under the Advisers Act. In addition, Rule 206(4)-7 under the Advisers Act makes it unlawful for an investment adviser to provide investment advice to clients unless such investment adviser has (i) adopted and implemented written policies and procedures reasonably designed to prevent violation, by the investment adviser and its supervised persons, of the Advisers Act and the Commission rules adopted thereunder; (ii) implemented, at a minimum, an annual review regarding the adequacy of the policies and procedures established pursuant to subparagraph (i) above and the effectiveness of their implementation; and (iii) designated an individual (who is a supervised person) responsible for administering the policies and procedures adopted under subparagraph (i) above.

<sup>34</sup> The Exchange states that FINRA surveils trading on the Exchange pursuant to a regulatory services agreement and that the Exchange is responsible for FINRA's performance under this regulatory services agreement.

equity securities. In support of this proposal, the Exchange has made representations, including the following:

- (1) The Shares will be subject to Rule 5735, which sets forth the initial and continued listing criteria applicable to Managed Fund Shares.
- (2) The Exchange has appropriate rules to facilitate transactions in the Shares during all trading sessions.
- (3) FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares and the other exchange-traded assets with other markets and other entities that are members of ISG,<sup>35</sup> and FINRA may obtain trading information regarding trading in the Shares and the other exchange-traded assets from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares and the other exchange-traded assets from markets and other entities that are members of ISG, which includes securities and futures exchanges, or with which the Exchange has in place a comprehensive surveillance sharing agreement. Moreover, FINRA, on behalf of the Exchange, will be able to access, as needed, trade information for certain fixed income securities held by the Fund reported to FINRA's TRACE.
- (4) Prior to the commencement of trading, the Exchange will inform its members in an Information Circular of the special characteristics and risks associated with trading the Shares. Specifically, the Information Circular will discuss the following: (a) the procedures for purchases and redemptions of Shares in creation

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<sup>35</sup> For a list of the current members of ISG, see [www.isgportal.org](http://www.isgportal.org). The Exchange notes that not all components of the Disclosed Portfolio may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.



units (and that Shares are not individually redeemable); (b) Nasdaq Rule 2111A, which imposes suitability obligations on Nasdaq members with respect to recommending transactions in the Shares to customers; (c) how information regarding the Intraday Indicative Value is disseminated; (d) the risks involved in trading the Shares during the Pre-Market and Post-Market Sessions when an updated Intraday Indicative Value will not be calculated or publicly disseminated; (e) the requirement that members deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; and (f) trading information.

- (5) For initial and continued listing, the Fund must be in compliance with Rule 10A-3 under the Act.<sup>36</sup>
- (6) At least 90% of the Fund's net assets that are invested in exchange-traded equity securities and exchange-traded derivatives (in the aggregate) will be invested in investments that trade in markets that are members of ISG or are parties to a comprehensive surveillance sharing agreement with the Exchange.
- (7) The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid securities (calculated at the time of investment), including securities deemed illiquid by the Adviser. The Fund will monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained, and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or

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<sup>36</sup> See 17 CFR 240.10A-3.

other circumstances, more than 15% of the Fund's net assets are held in illiquid assets.

- (8) Under normal market conditions, the Fund will seek to achieve its investment objectives by investing at least 80% of its net assets (including investment borrowings) in Mortgage-Related Investments. The Fund will limit its investments in Mortgage-Related Investments that are not issued or guaranteed by Government Entities to 20% of its net assets.
- (9) Under normal market conditions, no more than 20% of the value of the Fund's net assets will be invested in derivative instruments. The Fund's investments in derivative instruments will be consistent with the Fund's investment objectives and the 1940 Act and will not be used to seek to achieve a multiple or inverse multiple of an index.
- (10) The Fund intends to invest primarily in investment grade securities and will limit investments in securities of any credit quality, including securities that are below investment grade and securities that are unrated and have not been judged by the Adviser to be of comparable quality to rated investment grade securities, to 20% of its net assets.
- (11) A minimum of 100,000 Shares will be outstanding at the commencement of trading on the Exchange.

This approval order is based on all of the Exchange's representations, including those set forth above and in the Notice, and the Exchange's description of the Fund.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>37</sup> and the rules and regulations thereunder applicable to a national securities exchange.

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<sup>37</sup> 15 U.S.C. 78f(b)(5).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>38</sup> that the proposed rule change (SR-NASDAQ-2014-057) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>39</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

**BILLING CODE 8011-01p**

**[FR Doc. 2014-17034 Filed 07/18/2014 at 8:45 am; Publication Date: 07/21/2014]**

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<sup>38</sup> 15 U.S.C. 78s(b)(2).

<sup>39</sup> 17 CFR 200.30-3(a)(12).